Chapter 2

Kao’s Monozukuri Strategy

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Yoki-Monozukuri with ESG Perspective

The strong ESG-driven value creation foundations that we possess provide support for every Kao business, and our effective integration of a perspective based on our ESG Strategy is contributing toward the building of a sustainable society.

R&D

- Innovation capability through Essential Research.
- High-value-added product development capability.
- Unique technologies that realize outstanding performance.
- Developing products that reduce the burden on the environment.
- Developing products that can be used safely and with peace of mind.
- Transformative product development.
- Developing products that embody universal product design.

Marketing

- Thorough, consumer-driven marketing.
- A product development capability focused on delivering products that are genuinely useful for both consumers and society as a whole.
- Brands that cultivate close links with consumers, and which enjoy a high degree of loyalty.
- A comprehensive product line-up oriented toward enriching people's lifestyles.

- Cultivating purpose-driven brands.
- Environmentally-conscious brands and products creation that seeks to reduce plastic usage and cut CO2 emissions.

Logistics

- A seamless transportation and delivery network linking manufacturing to the customer.
- Cooperation between production and sales to realize highly efficient logistics.
- A reduced environmental impact due to promotion of modal shift implementation, joint transportation, etc.
- Sustainable Logistics Movement (a program launched by the Japanese government to make logistics more efficient) that fosters improvement of delivery drivers’ working environment.
- Controlling the amount of waste generated through the control of appropriate inventory levels.

Sales

- Ability to offer attractive solutions to retailers and other firms.
- Sales infrastructure that extends into around 100 countries and regions.
- A strong customer base.
- Reducing the amount of waste associated with returned goods, promotional items and special project items.
- A range of measures for working together with retailers to enhance logistical efficiency.
Consumption

- Innovation capability through Essential Research.
- High-value-added product development capability.
- Unique technologies that realize outstanding performance.
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Strengths

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- Cultivating purpose-driven brands.
- Environmentally-conscious brands and products creation that seeks to reduce plastic usage and cut CO2 emissions.
- Procurement that addresses environmental and social issues.
- Procurement risk management capabilities and stable product supply.
- Network of strong relationships with suppliers.

- Sustainable procurement taking care of environment.
- Implementing procurement that respects human rights and addresses labor issues.
- Dialogue with and support for small-scale agricultural producers.

ESG activities

- Factory capabilities that embody safe, stable manufacturing.
- High-quality, low-cost, environmentally-conscious production technology.
- Product supply driven by demand forecasting.

- Promotion of Responsible Care activities and effective chemical substance management.
- Utilization of renewable energy.
- A enhanced production system that realizes energy-saving and reduces greenhouse gas emissions.

- A seamless transportation and delivery network linking manufacturing to the customer.
- Cooperation between production and sales to realize highly efficient logistics.

- Ability to offer attractive solutions to retailers and other firms.
- Sales infrastructure that extends into around 100 countries and regions.
- A strong customer base.

- Reducing the amount of waste associated with returned goods, promotional items and special project items.
- A range of measures for working together with retailers to enhance logistical efficiency.

Moving forward together with consumers

- Reducing waste and promoting recycling.
- Reducing water usage.
- Reducing CO2 emissions.

Production

- Procurement that addresses environmental and social issues.
- Procurement risk management capabilities and stable product supply.
- Network of strong relationships with suppliers.

ESG activities

- Factory capabilities that embody safe, stable manufacturing.
- High-quality, low-cost, environmentally-conscious production technology.
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- A range of measures for working together with retailers to enhance logistical efficiency.
Research and Development

I believe the social issues that Kao should tackle are the excessive use of substances and energy associated with products over and above consumption, the rise in medical expenses in Japan and the decrease in healthy life-span by Japanese senior people. From the 20th century, manufacturing has been based on a free market economy, with repeated product battles caused by excessive products in the market, and many products being short-lived or being discarded without use. This has not been a sustainable economy for meeting the true needs of the market, where only the products that should be used are available in the minimum amount necessary and with the longest life possible. In terms of medical treatments as well, if we were able to maintain lifestyles that did not overly rely on therapies and medicines and maintain health with the minimum necessary medicines, the time and cost needed for medical treatments would be reduced.

Our goals for these major issues are to have consumers choose products with long life over the long term without competing. As one effort toward this, our RNA monitoring technology for skin, which aims to monitor people’s health at the genetic level while offering products and medical treatments optimized on an individual basis, is a leading proposal. If we can connect this technology with many other technologies and have it widely put into practical use, products that are not necessary or ineffective will be weeded out, with only the most effective products for consumers remaining. For the issues of ocean plastic waste and global warming as well, we do not aim to have our technologies be limited only to us, but plan to work together with many companies and universities with the goal of minimizing CO₂ emissions and maximizing useful materials.

Pursuit of Innovations for Solutions to Social Issues

While the demands placed on companies to achieve a sustainable future world are tremendous, special needs to satisfy people’s individual desires will continue to grow larger. In other words, we must achieve manufacturing that satisfies both sustainability and diversity at the same time. For this trend, I believe that this is very much the time for us to train a laser focus on what is essential. It is vital that we think about what forms the underlying basis, what should be prioritized and what should be changed, and integrate this into Yoki-Monozukuri. In this sense, our fundamental technology research that pursues Essential Research now has the opportunity to achieve meaningful contributions.

Essential Research

By thoroughly pursuing Essential Research, we will generate innovations to solve social issues and make great contributions to society as a whole.

Yoshihiro Hasebe
Representative Director, Senior Managing Executive Officer
Senior Vice President, Research and Development, Global
Senior Vice President, Strategic Innovative Technology, Global
Responsible for Compliance

Kao Integrated Report 2020
Working to Further Enhance Essential Research

Kao has adopted the following three basic policies for its R&D activities.
1. Create the seeds for new businesses
2. Bring about innovation that creates new consumers’ needs in existing business domains
3. Share scientific technologies with society

To realize these policies, we have reinforced matrix management for R&D activities, which brings together knowledge and goes beyond conventional technological domains. By putting in place an organizational structure in which individual research facilities report directly to the Research and Development Division, we have been able to realize faster decision-making and accelerated global growth. Matrix management makes it possible to integrate knowledge and technologies from many different fields, and the continuous linkage between our distinctive fundamental technologies and our new product development capabilities facilitates the generation of unique new product ideas that will create new value.

Mid-term Growth Strategy

The direction Kao should take is transforming into a leading company aiming to contribute to achieving the SDGs. We want to step into expanding intersections of our existing business from our business where we can currently use mobilize our core technologies. For example, these include the hygiene domain where our bioscience can make contributions primarily in controlling the spread of infectious diseases, the therapies domain where we can further enhance our skin care technologies to contribute to therapies adding beauty, and the recycling domain for sustainable conservation of food and the environment. I am confident that these new domains are areas where we can use our R&D assets effectively to help as many people as possible. Then we will aim to create technologies able to make possible things that have proven too difficult in the past and achieve world-first and world-leading social innovations with social impact.

Future Skin, created with Fine Fiber Technology, to develop the future of beauty and medical treatment

Fine Fiber Technology enables a light, soft, natural-feeling multi-layered and ultra-thin membrane made of superfine fibers with submicron diameters to be sprayed directly on the surface of the skin. We position this Fine Fiber Technology as one social innovation for solving social issues, and will deepen research on this technology looking at developments in the medical treatment domain in addition to the cosmetics domain encompassing skin care and makeup. We will continue to use innovations based on our Essential Research to solve social issues and contribute to people leading more beautiful and enriched lives.
Acting as a strategic coordinator with a focus on ESG-driven and stable procurement, we are aiming to achieve sustainable competitive advantage by building an even stronger network with our global business partners.

Masakazu Negoro
Managing Executive Officer
Senior Vice President, Procurement, Global

Efforts of the Procurement Division

Kao’s business operations are heavily dependent on natural resources, and resource scarcity can have a significant impact on the continuity of our business. This means that ESG-driven procurement, which embodies concern for both the environment—including natural resources saving—and society, is very important.

Regarding our initiatives to address social issues, we are using dialogue to identify issues of particular concern in relation to the working environment and living circumstances of small-scale oil palm farmers and the people who work on oil palm plantations, and we are putting in place a framework to realize appropriate corrective measures and providing working together with NGOs to provide necessary support. As part of these efforts, we provide technical assistance, together with our partners, to help local people enhance their productivity.

Promoting Yoki-Monozukuri with ESG perspective, stable procurement aimed at the stable provision of products to consumers and customers is also vitally important. We are promoting responsible procurement that is based on these two key aspects: ESG-driven and stable procurement.

In addition, by acting as a strategic coordinator for our individual businesses and their suppliers, and building up a Procurement Division is implementing strategic procurement that ensures a level of performance that will satisfy consumers and customers at a reasonable cost.

Through these initiatives, we are aiming to build sustainable competitive advantage.

The small-scale oil palm farmers in Indonesia

**Responsible procurement**

- ESG-driven procurement
  - Building a sustainable environment and society
  - Procurement of certified raw materials
  - Supplier monitoring
  - Support for small-scale oil palm farms

- Stable procurement
  - Ensuring the stable supply of products
  - Operational innovation
  - Supply chain improvement
  - Business Continuity Planning (BCP) initiatives

**Strategic procurement**

- Strategically coordinating the operations of Kao businesses and suppliers

- Yoki-Monozukuri
- Strengthening competitiveness over the mid- to long-term
- Realizing Yoki-Monozukuri from an ESG perspective
### ESG-driven Procurement Initiatives in FY2019

#### 1. Sustainable Procurement of palm oil and pulp

<table>
<thead>
<tr>
<th>Main initiatives</th>
<th>Main Results Achieved by FY2019</th>
<th>Impact on business operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Confirmation of traceability</td>
<td>• Palm oil</td>
<td>Identifying business risk</td>
</tr>
<tr>
<td></td>
<td>• For palm oil used in the Consumer Products Business, we have confirmed traceability as far as the palm oil mill.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• We are participating in the organization SUSTAIN, along with our Indonesian partners and NGOs.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• We are also implementing traceability to small-scale oil palm farmers, using block-chain technology, etc.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• By promoting the registration of both supplier and worker data, we are working to realize effective utilization of traceability.</td>
<td></td>
</tr>
<tr>
<td>Utilization of certified raw materials</td>
<td>• Palm oil</td>
<td>Establishment of a sustainable procurement framework</td>
</tr>
<tr>
<td></td>
<td>• As of FY2019, 92% of the palm oil used in the Consumer Products Business was RSPO certified, and we are aiming to increase this share to 100% in FY2020.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Pulp</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• As of FY2019, 91% of the paper and pulp used in the Consumer Products Business was FSC- or PEFC-certified, and we are aiming to increase this share to 100% by FY2025.</td>
<td></td>
</tr>
</tbody>
</table>

#### 2. Supplier monitoring from an environmental and social perspective

<table>
<thead>
<tr>
<th>Main initiatives</th>
<th>Main Results Achieved by FY2019</th>
<th>Impact on business operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective utilization of Sedex for monitoring ESG initiatives</td>
<td>• To verify compliance with supplier guidelines, we ask suppliers to join the Supplier Ethical Data Exchange (Sedex), and to respond to questions and provide us with access to data.</td>
<td>Identifying business risk</td>
</tr>
<tr>
<td></td>
<td>• To date, access rights have been established for 1,800 sites. We aim to continue expanding the scope of access rights in the future.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• We implement risk evaluation through Sedex assessment. We provide suppliers with feedback on assessment results, and ask them to make improvements where needed.</td>
<td>Risk reduction through supply chain improvement</td>
</tr>
<tr>
<td>Participation in the CDP supply chain program to help realize sustainable raw materials procurement</td>
<td>• We participate in the Carbon Disclosure Project (CDP) supply chain program.</td>
<td>Identifying business risk</td>
</tr>
<tr>
<td></td>
<td>• We are the only Japanese company that requires suppliers to implement disclosure in the three key areas of Climate Change, Water and Forests.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Through participation in the CDP supply chain program, we encourage suppliers to realize sustainable raw materials procurement.</td>
<td>Risk reduction through supply chain improvement</td>
</tr>
<tr>
<td></td>
<td>• Kao was the first Japanese company to be selected for inclusion in the CDP Supplier Engagement Leader Board.</td>
<td></td>
</tr>
</tbody>
</table>

#### 3. Promoting centralized purchasing of indirect materials and “green” procurement

We are integrating our internal processes for indirect materials purchasing. By implementing purchasing using a single, unified system, we are able to realize the visualization of purchasing content, and ensure effective governance.

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**RSPO (Roundtable on Sustainable Palm Oil)**

The RSPO is a non-profit organization that seeks to promote the production and use of sustainable palm oil through the formulation of certification standards and through stakeholder participation. Kao joined the RSPO in 2007.

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**Sedex (Supplier Ethical Data Exchange)**

Sedex is a collaborative platform with the objective of promoting ethical, responsible business practices in the supply chain. Kao joined Sedex in 2014.

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**SUSTAIN (Sustainability Assurance & Innovation Alliance)**

SUSTAIN is an initiative that aims to realize supply chain data transparency through collaboration between palm oil stakeholders that makes effective use of block-chain technology. Kao joined SUSTAIN in 2018.

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**FSC (Forest Stewardship Council)**

The FSC promotes the use of pulp products that are certified by international bodies engaged in providing certification for the management of the world’s timber-producing forests, and for the distribution and processing of the timber extracted from these forests.

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**CDP Supply Chain**

CDP Supply Chain is a program implemented in the supply chain that uses questionnaire surveys to analyze and evaluate data on CO2 emissions and climate change related initiatives. Kao began asking suppliers to fill out CDP Supply Chain questionnaires in 2009.
Supply Chain Management

Through the effective utilization of cutting-edge technology and collaborative innovation with individual suppliers, we are building an advanced, socially beneficial, and environmentally conscious supply chain that supports the stable supply of our products.

Osamu Tabata
Managing Executive Officer
Senior Vice President, Supply Chain Management, Global
Responsible for TCR1 Promotion

Supply Chain Management Initiatives

The environment of supply chain in which Kao operates is undergoing a dramatic transformation. With the diversification of lifestyles and values, the growth of the e-commerce market, etc., products have become more diversified, and there have been changes in the types of products that sell particularly well. In responding to this changing environment, our supply chain management strategy is focused on producing reliable products as efficiently as possible, and on ensuring the stable delivery of the products that consumers need.

We have built a supply system that is based on an integrated framework incorporating every stage from procurement through to production and sales, with close collaboration between related divisions and centralized management of information, so that demand can be forecast at the level of individual products, after which we undertake procurement based on the level of demand, implement production and then deliver products to our customers in a stable, reliable manner. So as to build an even more advanced supply chain, we are aiming to reduce our environmental impact and improve transportation efficiency, and to this end we are working to enhance our framework for collaboration with other stakeholders.

By making effective use of environmentally conscious production technology, undertaking production with consistently high quality, and building an efficient logistics network, we are able to ensure the stable supply of products.

Building an Advanced Supply Chain

In the future, we will be working to make our supply chain even better. Currently, our product supply plan—which is based on our overall business plan and on demand planning—incorporates advanced technology such as artificial intelligence (AI) into an integrated, common platform, and we are implementing initiatives to enhance the precision of demand forecasting, automate production planning and optimize inventory management, as we seek to drive supply chain improvement on a global scale.

More specifically, we aim to improve the precision of demand forecasting through the effective utilization of AI and other digital technologies, by undertaking detailed analysis of consumer needs and market trends. In addition, by automating production planning for production lines that are engaged in the manufacturing of multiple different products—a highly complex task that requires extensive experience—we are working to make planning more precise and enhance operational efficiency. In this way, we can optimize materials order placement volume and inventory levels, thereby making it less likely that we will miss out on sales opportunities due to having insufficient inventory, or generate large amounts of waste product due to excessively high inventory levels. Through the automation of production planning, we are aiming not only to realize the optimization of operations that in the past depended on the experience and nous of individual personnel, but also to achieve a dramatic improvement in productivity.

*1 Total Cost Reduction (TCR) is a business innovation activity that involves participation by all employees from a comprehensive perspective.
ESG-driven Supply Chain Management

Demonstrating Concern for the Environment

Besides working to optimize production and logistics, we are also linking production planning and logistics planning together and promoting collaborative innovation with suppliers, aiming to eliminate overburden, waste and inconsistency throughout the supply chain and reduce our environmental impact.

Furthermore, in addition to our existing energy-saving activities, we are also taking steps to further reduce CO₂ emissions by proactively adopting natural energy sources such as photovoltaic power and wind power, and making effective use of biomass energy, etc. By making an active effort to use electric power that has been generated using renewable energy, we are driving a further reduction in CO₂ emissions in supply chain activities. In addition, regarding the reduction of the use of refrigerants with a high ozone depletion potential (ODP) in line with the Montreal Protocol on Substances that Deplete the Ozone Layer, we have also decided to try to reduce the global warming potential (GWP) of the refrigerants that we use, in accordance with the Kigali Amendment to the Montreal Protocol. We are working to reduce the use of alternative CFCs (hydrofluorocarbons) that, while having an ODP of zero, have a high GWP, by proactively switching over to natural refrigerants and “green” refrigerants (hydrofluoroolefins, etc.). At the same time, in regard to our efforts to achieve zero waste—particularly with respect to plastic waste—we are going beyond conventional supply chain activities and are striving to reduce waste throughout over the entire product lifecycle through collaboration with R&D and with external actors, including government, industry and academia.

Demonstrating Concern for Working People

The building of an efficient, appropriately-managed supply chain helps to reduce our environmental impact by making transportation more efficient, while also having positive benefits for working people.

In the future, our integrated seamless transport and delivery network—which links every stage from manufacturing to the customer, and is one of the key strengths of our supply chain—will link logistics information with external parties, with the further evolution of measures to realize joint transport with other manufacturers, etc., thereby driving the enhancement of overall transport efficiency. This in turn will lead to an improvement in working conditions for people working in the logistics industry, which has been affected by severe labor shortages, and where long working hours have become the norm.

We are also working actively to promote the Sustainable Logistics Movement by enhancing supply chain efficiency through the active utilization of pallets with RFID tags attached in smoother product transportation, which facilitates the automation of storage and retrieval operations at logistics centers, and makes for improved product information traceability. Furthermore, in regard to chemical substance management, through inter-divisional activities to promote the Strategic Approach to International Chemicals Management (SAICM) we are implementing appropriate management throughout the entire chemical substance lifecycle, from development and manufacturing through to usage and disposal, with the aim of contributing to the realization of a sustainable society. In Supply Chain Management Department, with regard to production sites that handle chemical substances at every stage from raw materials through to finished products, in order to safeguard both operators’ health and the environment from negative impacts, besides implementing conventional risk assessments and response measures, we also undertake risk assessments and formulate response measures for new substances that have just been adopted.

Proactive Adoption of Solar Panels

Kao is promoting the adoption of renewable energy facilities such as solar panels at all production sites, both within and outside Japan.

Tochigi Plant (located in Ichikai-machi, Haga-gun, Tochigi Prefecture, Japan)
Overview of Kao’s Business in FY2019

<table>
<thead>
<tr>
<th>Business</th>
<th>Net Sales</th>
<th>Operating Income</th>
<th>Operating Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cosmetics Business</strong></td>
<td>301.5 billion yen</td>
<td>41.4 billion yen</td>
<td>13.7%</td>
</tr>
<tr>
<td><strong>Skin Care and Hair Care Business</strong></td>
<td>340.8 billion yen</td>
<td>49.5 billion yen</td>
<td>14.5%</td>
</tr>
<tr>
<td><strong>Human Health Care Business</strong></td>
<td>255.2 billion yen</td>
<td>17.2 billion yen</td>
<td>6.7%</td>
</tr>
<tr>
<td><strong>Fabric and Home Care Business</strong></td>
<td>359.5 billion yen</td>
<td>71.8 billion yen</td>
<td>20.0%</td>
</tr>
<tr>
<td><strong>Chemical Business</strong></td>
<td>285.9 billion yen</td>
<td>30.8 billion yen</td>
<td>10.8%</td>
</tr>
</tbody>
</table>

*1 Like-for-like growth rates exclude the effect of currency translation.
*2 Share of net sales is calculated based on sales to customers. Share of operating income is calculated before the elimination of intersegment transactions.
*3 Net sales and operating income of the Chemical Business include intersegment transactions.
**Cosmetics Business**

In order to respond to the diverse beauty values of each individual consumer, we are refining the characteristics of our brands and delivering skin care and make-up products to consumers.

**Skin Care and Hair Care Business**

We deliver mass-market skin care products and hair care products to people all over the world so that they are able to express their desired personalities, and in doing so we contribute to the realization of truly healthy, beautiful skin and hair.

**Human Health Care Business**

We deliver hygiene products which are gentle on the skin, along with functional beverages promoting new health values and products that support healthier and more comfortable daily lifestyles, including toothpaste and bath additives.

**Fabric and Home Care Business**

We provide fabric and home care products so that as many people as possible can create moments of cleanliness in their daily lives.

**Chemical Business**

We provide a wide range of chemical products, including oleo chemicals made from natural fats and oils, performance chemicals such as surfactants, and specialty chemicals including toner and toner binders.
Net Sales and Operating Income

With a sincere approach to our consumers, the creation of products that are truly needed by society enables Kao to create value and achieve profitable growth.

Tomoharu Matsuda
Director, Managing Executive Officer
President, Consumer Products, Global

The Social Situation Surrounding the Kao’s Business

Conditions in the global economy are unclear due in part to international trade disputes and the novel coronavirus (COVID-19) pandemic as well as uncertainty surrounding the direction of economic growth in various countries. The market in Japan has been affected primarily in the cosmetics market from falling demand for products bought for the purpose of reselling due to changes in the China’s e-commerce law that took effect in January 2019. In addition, the adverse weather conditions in the first half of the year also affected the seasonal products market including the market for UV care products, etc. Economic recovery after the consumption tax rate increase enacted in October has also been slow. The markets for household and personal care products and cosmetics in Japan which are key markets for the Kao Group, saw a great deal of volatility from last-minute demand before the consumption tax rate increase and its growth weakened as the decline in sales after the last-minute demand, but for the full year the markets posted solid performance on a value basis.

A series of environmentally-conscious products were launched in FY2019. Digitalization has also advanced, and the markets for household and personal care products and cosmetics in Japan are seeing not only e-commerce but a variety of new business models including subscription models, and gaining an understanding of consumption conditions has become quite complex. Desire for sustainability has risen further, and companies today are expected to respond to needs and calls for product safety and reliability.
FY2019 Results and Issues

Sales increased 2.0% (increased 2.9% on a like-for-like basis) compared with FY2018 to 1,257.0 billion yen.

In the Cosmetics Business, the new strategy we undertook in 2018 generated strong performance, and we achieved the K20 plan of net sales of 300 billion yen and an operating margin of 10% one year ahead of the plan. We will step up efforts in the growing e-commerce and travel retail sales channels, and further enhance our business in Asia.

In the Skin Care and Hair Care Business, sales of the new body cleanser Bioré u The Body achieved steady growth. While we posted solid performance in Asia, in the Americas we were impacted by intense competition and sales decreased. We will work to activate the market by shifting more toward offering high-value-added products and making distinctive and attractive offerings unique to the Kao Group.

In hair care products, hair color products in Japan and the Oribe, a brand in the Americas for hair salons, achieved strong performance. Overall, however, hair care products were affected by the shrinking mass market. We will strive to offer brand value and activate the market with distinctive product offerings while establishing both mass brands and premium brands.

The Human Health Care Business was impacted by a substantial decline in Japan in demand for Merries baby diapers for the purpose of resale in the Chinese market, but nevertheless grew its market share in Japan. Laurier sanitary napkins posted sales growth in Japan and Asia with strong sales of high-value-added products. We will increase the value of our products and build up our brand equity.

In the Fabric and Home Care Business, Attack ZERO laundry detergent was launched in Japan, and sales grew compared with FY2018. Home care products saw sales growth in dish-washing detergents and household cleaning products. We are also taking steps to develop high-value-added products and reduce the amount of plastic use by shifting to refill products and larger-capacity container.

We are also seeking out challenges in new product categories as well. In the hygiene business domain, we launched the brand sonae in the hygiene business domain and PAF, a temporary pinpoint coloring product popular with young people to bring more excitement to special days.

Net sales in Asia increased 3.8% or 6.7% on a like-for-like basis, to 206.3 billion yen in FY2019.

Our business in Asia is aiming to maximize brand equity in concert with Japan. To do this, Japan and Asia are working together to implement brand enhancing initiatives. The business in Asia, primarily Kao China and Kao Indonesia, contribute significantly to the Kao Group’s growth.

FY2019 sales by region in the Consumer Products Business

<table>
<thead>
<tr>
<th>Region</th>
<th>Net sales (Billions of yen)</th>
<th>Year-on-year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>899.6</td>
<td>+15.7</td>
</tr>
<tr>
<td>Asia</td>
<td>206.3</td>
<td>+7.6</td>
</tr>
<tr>
<td>Americas</td>
<td>88.8</td>
<td>+3.8</td>
</tr>
<tr>
<td>Europe</td>
<td>62.2</td>
<td>-3.0</td>
</tr>
<tr>
<td>Total</td>
<td>1,257.0</td>
<td>+24.1</td>
</tr>
</tbody>
</table>

* Figures present sales to external customers, and sales by geographic region are classified based on the location of the sales recognized.
At Kao, our brand purpose is to have positive effects on consumers’ lives and on the society and the environment, and to realize sustainable lifestyles.

That Kao’s brands help make the world and society that consumers live in a better place needs to be well understood by society and consumers and Kao’s brands need to be chosen.

To achieve this in a world where drastic change is predicted, we need to respond to consumers’ needs and concerns in relation to their changing values and social issues, and co-create value together with consumers.

Key here is positioning the question of what value the products Kao create can offer consumers as the starting point of product value creation, and taking the approach in day-to-day marketing of integrating this into product development and communications.

At Kao, we conduct Life Value Solution marketing aimed at providing benefit for consumers’ Life Value through our business activities.

To realize the sustainable society that we are aiming to create together with consumers, we must take actions through our brands, which are the greatest point of contact we have with consumers.

As a first step, we will clarify the social issues that each brand will focus on addressing as well as update the brand design guide that forms the foundation for the respective brand’s value design, define the brand purpose as a higher-level concept to the brand vision and mission, and make clear brands’ purpose for existing, meaning how they will contribute to society and the world.

Based on the brand purpose, we design brands from the product development stage with universal design perspectives as well as ESG perspectives focused on society and the world. It is important that consumers perceive new value from outstanding product performance leveraging the technology innovations that we have built up as our strength. This value experience can deepen the bonds between consumers and Kao. Through this robust engagement, we believe information will be communicated by consumers. In this way, we will create feelings of empathy with consumers and build up our brand value.

In the future, we will expand our purpose-driven brands that offer ways for consumers to realize better lifestyles and begin solving social issues. This kind of business activity leads to the company achieving sustainable and profitable growth, and realizes a cycle where this is then invested in addressing new social issues.

Having our products be close to consumers’ daily lives, and creating this daily reality, is what truly brings us joy.
Toward 2020 and beyond

While offering products that combine our proven quality, made possible by our industry-leading expertise in the area of skin science and beauty-enhancing qualities, with emotional and sensory appeal, we aim to build on the distinctive identities of each of our brands and create a global presence for our businesses. We will engage in creation of strong brands by continuing to offer consumers exciting brand experiences. At the same time, Kao will seek out various growth opportunities from the increasing cross-border exchanges of people and information as well as new digital technology to conduct forward-looking and innovative business operations.

Offering Solutions to Social Issues

Through beauty, the Cosmetics Business engages in social value creation with the ability to offer moments of joy in daily life. By managing our business with an ESG perspective, Kao is contributing to realizing a society in which fulfilling lives are possible for all, throughout the world. In promoting the use of environmentally conscious, renewable resources in our ingredients, containers and packaging, the use of renewable energy in production and distribution processes and waste reduction in the use stage by the consumer, Kao makes contributions to the sustainability of the world across the value chain.

Global Portfolio

We established the New Global Portfolio, consisting of five business entities in the Cosmetics Business, in May 2018. For the 11 brands selected as global strategic brands (G11), Kao will actively pursue expansion of the areas in which they are offered. Meanwhile, by also enhancing our travel retail business, Kao will accelerate their development in Japan and elsewhere in Asia and in Europe. Kao has designated eight regional brands (R8) for priority development mainly in Japan and will concentrate investment in them to support their development.

Reorganization of counseling and self-selection brands

In Japan, Kao will drive creation of strong brands with clearly redefined brand positioning. Kao will reorganize its existing brands into counseling brands, which are sold via beauty consultants who have received specialized education, and self-selection brands, and revise how the brands are designed and sold.

Management reform

In January 2019, we introduced a brand team system to better respond to the fast pace of change in the business environment. The brand teams will implement the Plan, Do, Check, Action (PDCA) cycle in more adoptable and faster cycles. Authority will be delegated to brand team leaders, who will conduct targeted marketing at a brisk pace.
Skin Care and Hair Care Business

Toward 2020 and beyond
Kao will develop unique products with high-added-value to drive our global expansion as a highly profitable business. With a sharp focus on consumers' attitudes to beauty and changes in lifestyle habits, Kao will accelerate the shift toward delivering high-value-added products and play a leading role in invigorating the market by creating distinctive and attractive product offerings that are unique to Kao. To contribute toward the realization of healthy, beautiful skin and hair for people throughout the world, Kao will enhance its business operations by launching and developing distinctive, appealing new products, and by engaging in marketing activities that stay ahead of consumers' changing purchasing behavior.

Offering Solutions to Social Issues
The impact on the global environment of the excessive use of plastic is a source of concern. We have developed new thin-film refill containers as well as the Smart Holder, which allows consumers to insert a pump directly into refill products and use them, providing a solution that is both environmentally conscious and easy to use. With the introduction of new air-in film bottles, we reduce the amount of plastic needed, and speed up of initiatives to reduce plastic usage. Through those efforts, we are working to reduce CO2 emissions on a product lifecycle assessment basis, from production to disposal, thereby contributing proactively toward the sustainability of the world.

Strategy

Skin care
We will strive to expand our business domain with bold moves via development of new technology to address environmental stressors that affect skin, centered on UV care and deodorant, and to meet needs in the hygiene domain in addition to reinforcing our unique positioning and further enhancing our high-value-added offerings in the cleansing products, which constitutes the core element in the skin care.

Hair care
While working to bring greater clarity to our product portfolio with its many different brands, we are working to create new value by precisely targeting current trends and actively pursuing development of high-value-added products that provide real value in consumers’ daily lives. In our business for hair salons, we have developed a thorough understanding of hair stylist needs, and we are meeting these needs through the development and provision of innovative new products and services.

Business area expansion
The global skin care brands Biore and Jergens will evolve to facilitate their global growth as we develop their product lines to drive expansion into the countries and regions in which they have not previously been offered. In our business for hair salons, while driving growth in the high-end segment through Oribe, we will be working steadily to create synergies with Goldwell in the North American market, while also accelerating global expansion.
Human Health Care Business

Toward 2020 and beyond

Kao will offer high-value-added products and solutions that support the physical and mental health of people all ages with the goal of enhancing people's vitality and contributing to the creation of healthy lifestyles around the world. Kao will promote product development that focuses on both physical and mental health in our hygiene health products. In our hygiene products, Kao strives to create products that are gentle on the skin and provide high levels of comfort and peace of mind. In functional beverages, Kao offers differentiated products with enhanced functional health value.

Offering Solutions to Social Issues

Kao will support people around the world to help them enjoy improved health through activities focused on mothers and infants in maternity wards, first menstrual education in elementary schools, and enlightenment on adult incontinence products and oral care in hospitals and care facilities. We will also help to enrich people's lives by helping them to keep in better physical condition, leading to reduced fatigue and lower stress.

Strategy

Kao is accelerating our global expansion with evidence-based, high-value-added products offering unique health care propositions. First, led by Merries, Laurier and MegRhythm brands, Kao intends to offer products with greater customization to fit local health care needs while collaborating with and creating a network of universities, medical professionals and other experts in each country. Based on consumption patterns and distribution conditions in each country, we will work to efficiently expand product lines new and the countries and regions through strategic use of distributors and growing e-commerce channels.
Our strategy is to develop high-value added products utilizing the results of our Essential Research, and offer solutions that are easy to understand, easy to use, and otherwise accessible to a wide range of people. Kao will create even more Kirei in everyday life to deepen our ties to consumers and contribute to increased market revitalization.

Standards of living vary in different countries and regions, and laundry environments (clothing, water quality, washing methods) and living environments also differ throughout Asia. Kao will apply the value-added sanitation technology we have built up in Japan in ways that fit each country and region to realize thorough localization and contribute to making consumers’ lives better.

The Attack brand in the fabric care and the Magiclean brand in the home care have won widespread popularity among consumers in Asia, and Kao will develop them into well-loved brands. We will also speed up our business development not only in countries where we already have business operations, but also in neighboring emerging markets in Asia and elsewhere.

Toward 2020 and beyond

People’s attitudes to and their habits in relation to housework, such as laundry and cleaning, are undergoing a major transformation due to the greater diversity of living environments and lifestyles as well as other social factors. Different countries and regions each have their own emerging needs as standards of living improve. While staying attuned to what different consumers want in life, we will use the insights we gain from them to take the lead in activities to solve various social issues. By offering products and solutions with high-added-value that enable anyone around the world to live each day in greater cleanliness and comfort, we contribute to realizing greater contentment in daily life.

Offering Solutions to Social Issues

Kao believes it is our role to accurately understand consumers’ changing attitudes and habits in the area of laundry, cleaning and other housework, and to take the lead in helping to solve various social issues. In the Fabric and Home Care Business, we have taken actions to reduce our environmental impact at every stage of the product lifecycle, for example by making products more concentrated so that their containers can be more compact, thereby reducing the amount of plastic used, and by increasing the use of refill and replacement products. In the future, we will be proactively contributing toward the sustainability of society through initiatives aimed at reducing the amount of plastic used, for example by eliminating eye-catching plastic stickers used on products, and switching over to larger-volume containers, etc.
Professional-use Products

Toward 2020 and beyond

For our corporate customers, including restaurants and other food services businesses, medical and care facilities, hotels and laundry firms, we provide products which make full use of our cleaning, anti-bacterial, odor removal and other technologies, along with total solutions that match individual client companies’ needs. By providing products that are used safely, securely and effectively and which are environmentally conscious, and delivering solutions for customers’ issues, we not only help to enhance the corporate value of our customers, but also contribute to society by realizing clean environments and enhanced hygiene management in a wide range of living environments outside the home.

* Professional-use products are included within the Fabric and Home Care Business.

Offering Solutions to Social Issues

Food poisoning incidents resulting from unsatisfactory hygiene management, and infection by norovirus, coronavirus, etc., constitute ongoing social issues. Through the provision of effective cleaning products and by assisting front-line workers in the achievement of thorough hygiene management, we are working to help solve these issues. In the aging society, we offer solutions for the realization of human-centric care environments that not only enhance quality of life for care recipients but also reduce the burden on care providers. With regard to the labor shortage due to the trend toward declining birthrate, by offering efficient, effective operational systems we are striving to contribute toward the resolution of this issue.

Strategy

We aim to provide an extensive range of high-quality products through our expertise in R&D and through product development that is oriented toward the actual needs of professional workplaces such as restaurants and other food service providers, hotels and other types of accommodation, medical institutions and care facilities, etc. We also contribute toward the enhancement of our customers’ corporate value, by offering hygiene management solutions.

Viewing the major changes taking place in the professional-use products business environment—including the trend for the food services market to be dominated by a handful of major chains, growing demand for take-out food, the continuing increase in inbound tourist visitors to Japan, and the acceleration of the aging of the population—as opportunities for business growth, we grow our business still further by increasing the market share held by existing businesses and also taking up the challenge of expanding into new business areas.

In addition, in 2018 we acquired U.S.-based company Washing Systems, LLC (WSI), a firm engaged in the development and sale of professional-use cleaning products. WSI, which received the 2019 Green Chemistry Challenge Award (awarded jointly by the U.S. Environmental Protection Agency and the American Chemical Society), has been contributing toward reducing the environmental impact of the U.S. professional-use cleaning industry by providing cleaning agency delivery systems that incorporate environmentally conscious cleaning agents. In the future, WSI will be making effective use of synergy with Kao’s R&D expertise to achieve further growth as a global business.
Consumer Products Sales

Viewing changing circumstances surrounding our business as growth opportunities, build a new sales structure and sales channels aiming to achieve further growth.

Toshiaki Takeuchi
Representative Director, Senior Managing Executive Officer
Representative Director, President, Kao Group Customer Marketing Co., Ltd.

Changes in Conditions Affecting Business

The Consumer Products Sales Department has striven to create a better society and increase consumer satisfaction by providing new value to society and consumers and creating new markets together with retailers. Over the last several years in particular, advances in digital technology and changing consumer values have significantly changed how consumers live their lives and how they choose and buy products. Responding to these changes in society, retailers are also making big changes, from monopolizing market segments to focusing on the e-commerce business and developing new types of physical stores.

To address these major changes taking place in society and continue providing new value, companies must also transform themselves. Up to now, we have provided value to society and consumers mainly through the mass-market business, but in the future we will need to modify our business model so that we can deliver high-added-value products to individual consumers through one-to-one marketing using digital and other tools.

We will shift our sales activities to meet the needs of the changing times, continue to provide new value to consumers, and take steps that enable continuous growth at retailers and at us.

Meeting Needs in Increasingly Borderless Markets

Developments in smartphones and other digital technologies and the globalization of the retail industry have rapidly advanced the borderlessness of products and distribution in markets. Barriers between online and offline channels are gradually being eliminated not only China and United States, which have been at the forefront of this trend, but also Japan, other parts of Asia and Europe, and where consumers get their information from and their consumption behavior are undergoing substantial changes around the world. In order to communicate our value to consumers as borderlessness advances on all sorts of fronts in this way, we need to fully engage in one-to-one marketing, where we take the massive amount of data collected through digital means and customize it for individual consumers. We will advance our efforts taken in collaboration with the retailers in Japan, with e-commerce companies developing cross-border business, and with global retailers, and innovate our activities to communicate the quality of Kao products and services to consumers in a wide range of countries and regions toward our goal of becoming a company with a global presence.
Promoting Sales Activities Integrating ESG-driven Management

Going forward, we will fully implement sales activities integrating ESG in partnership with retailers.

To expand sales and profit at both retailers and us, we must continue to offer new value to people and contribute to the enrichment of people’s lives. Meanwhile, for consumers to lead enriched lives in the true sense of the word, we must consider the global environment and society, and contribute to creating a sustainable world. Based on this thinking, the Sales Department is also integrating ESG to have a greater positive impact on people, society and the local communities than before.

Specific sales activities integrating ESG that we are conducting include zero waste initiatives and increasing logistics efficiency.

1. Zero waste initiatives
We have taken actions to reduce waste in the past as well, including reducing the volume of promotional materials. We still have many types of waste, such as discontinued products and used promotional materials, however, that have impacts on the global environment. We will take the activities that we have been implementing a step further, and for issues that are difficult for one company to resolve on its own, we will conduct ESG-driven initiatives to reduce our environmental impact together with various stakeholders.

Specific actions of our zero waste initiatives

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<table>
<thead>
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<tbody>
<tr>
<td>1</td>
<td>Minimizing/eliminating product returns</td>
</tr>
<tr>
<td>2</td>
<td>Fundamentally reviewing promotional materials</td>
</tr>
<tr>
<td>3</td>
<td>Reviewing in-store promotional products plans</td>
</tr>
</tbody>
</table>

2. Increasing logistics efficiency
Recent increases in the volume of delivered goods and delivery frequency, coupled with a shortage of truck drivers, have caused worsening work conditions for truck drivers and a home delivery crisis, which have risen to the level of social issues. A less-than-optimum logistics structure also causes greater impact on the environment and can be cited as a problem. We are working to resolve this problem by increasing our logistics efficiency.

Specifically, we are implementing initiatives including securing lead time before deliveries, alleviating wait times for truck drivers, and equalizing quantities delivered to the logistics warehouses of chain stores. In partnership with various stakeholders throughout the supply chain, we are reducing the number of trucks in operation and the time truck drivers spend at work. In promoting these kinds of initiatives, we have also declared our support for the “Sustainable Logistics Movement” put forward by the Japanese Ministry of Land, Infrastructure, Transport and Tourism.

Without being constrained by traditional values, we will deepen the quality of these initiatives by moving ahead with reforms and advance sales activities that are able to contribute to the global environment, society and consumers.
We offer innovative products and solutions as a global leading company, basing business decisions on the criteria of the benefit to the environment and society.

Masahiro Katayose
Executive Officers
President, Chemical Business, Global

Social Issues Affecting Business
Social issues affecting the business are growing more diverse, while their degree of impact is also increasing. Specifically, issues that can be cited include climate change and global-scale environmental changes such as water and food scarcity, stricter environmental regulations that have been enacted in many countries backed by people’s heightened awareness of these changes, and economic changes including trade frictions and the worldwide economic slowdown. In addition, we are being called on to exercise more consideration than before regarding the raw materials we use in light of biodiversity impacts and human rights issues.

Business Opportunities and Risks
Viewing these changes rather as opportunities, through technology innovations in chemicals we will contribute to resolving social issues, meet changing customer needs and support technological advances.

In our oleo chemicals, whose main raw materials are natural fats and oils, the market entry by raw materials manufacturers is increasing the commoditization of products, and we will strengthen development of distinctive and sustainable fat and oil derivatives. In the information materials and performance chemicals, we are currently developing innovative products with greater levels of customization, aiming to further reduce environmental impact.

Net Sales*2 and Operating Income

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Net Sales (Billions of yen)</th>
<th>Operating Income (Billions of yen)</th>
<th>Operating Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>288.5</td>
<td>30.1</td>
<td>10.4%</td>
</tr>
<tr>
<td>2015</td>
<td>288.5</td>
<td>28.6</td>
<td>9.9%</td>
</tr>
<tr>
<td>2016</td>
<td>273.8</td>
<td>29.7</td>
<td>10.8%</td>
</tr>
<tr>
<td>2017</td>
<td>310.3</td>
<td>30.3</td>
<td>9.8%</td>
</tr>
<tr>
<td>2018</td>
<td>312.8</td>
<td>30.6</td>
<td>10.8%</td>
</tr>
<tr>
<td>2019</td>
<td>285.9</td>
<td>30.8</td>
<td>10.8%</td>
</tr>
</tbody>
</table>

*1 Like-for-like growth rates exclude the effect of translation of local currencies into Japanese yen.
*2 Includes intersegment transactions.
Business Strengths

We are one of the leading global companies in the oleochemicals that handles derivatives and surfactants, primarily from fatty alcohols and surfactants with one of the largest production capacity in the world. Leveraging our core technologies including in nano-level surface modification and molecular design of performance chemicals, we offer innovative chemical products that support industry development.

The Chemical Business can also count among its strengths a global business foundation and human capital as well as a broad customer base spread across many industries.

Chemical Business Strategy

In the Chemical Business, we deliver innovative products and solutions offering value from chemicals to help customers and the industry solve issues. We make business decisions based on the criteria of whether a product or solution will benefit the environment and society. Our basic strategy is to achieve profitable growth based on this business direction and contribute to creating the future of industry and sustainability around the world.

The synergies we demonstrate with the Consumer Products Business are distinctive features of the Chemical Business. We not only supply basic raw materials for the Kao Group companies’ consumer products, the fundamental technologies that we have sophisticated through meeting the needs of world markets and customers are also applied to consumer products’ research and development.

FY2019 Results and FY2020 Activities

In FY2019, sales decreased due to effects from selling price adjustments associated with a decline in prices for natural fats and oils in oleo chemicals, and from declining global demand particularly for information materials and performance chemicals. We achieved record-high operating income with strong sales of high-value-added fats and oils derivatives outside Japan.

In FY2020, in addition to increasing our sales ratio of high-value-added products that are less affected by fluctuations in raw material prices, we will further reinforce production of eco-chemical products with reduced environmental impact and create new business. As a growth engine in particular, we intend to enhance our business in distinctive fats and oils derivatives, infrastructure-related chemicals and inkjet inks for industrial printing.